RAILROAD WEEK IN REVIEW
November 16, 2018

"Large passive ETF marketers who may know little to nothing about the individual stocks they hold can serve to extend the life of questionable enterprises in an artificial manner." — Almost Daily Grants, Nov 7

"US GDP growth peaked in Q2. On examination, we can see that part of the Q3 growth was inventory building in anticipation of more tariffs. Who can rationally blame any American company from trying to protect itself from an unpredictable and incoherent policy?" — David Kotok, Cumberland Advisers, Nov 15.

Precision Scheduled Railroading (PSR) is the subject of a recent note from Cowen railroad analyst Jason Seidl. He writes that NS and UP have not done well at keeping the customers ahead of the PSR learning curve. Even though Cowen's work finds that PSR can improve margins and earnings, customers are wary of anything that can disrupt supply chains.

Wariness is a function of not knowing what's next, so communication with shippers is critical to a successful rollout of a new operating plan. Says Cowen, neither railroad has approached much more than half their customers about what to expect — service disruptions, fewer trains, changes to demurrage and other accessorial fees, and no change in sales coverage.

[*Bad move. If anything, customers deserve better coverage in times of change. Recall CP telling short lines at their September confab that they are increasing shoreline sales coverage along with everybody else, and that CP sales reps have limited pricing authority which they can use on the spot to enhance the customer relationship. — rhb*]

Jason points out that Norfolk introduced "Clean Sheeting" — what they're calling their version of PSR — as a means for simplifying the network and creating capacity in the bargain. On their Q3 earnings call, NS "touted some of their achievements from clean sheeting to this point, including improved train performance and terminal dwell statistics."

Union Pacific's "Unified Plan 2020" started rolling out last month. The focus is on "moving trains rather than cars, minimizing dwell times, and improving utilization of crews and assets." UP has acknowledged that it has not been meeting customer expectations and that the PSR rollout is designed to address this shortcoming. Jason concludes,

> As can be seen from the name each railroad has given their version of PSR, both rails are using terminology associated closely with PSR (“network rationalizations,” “headcount reduction,” “changing to flat-switching yards”). However, the analyst community is waiting for further details and actual results to see if the rails are doing true PSR, or are simply using some of the terminology to try and show Wall Street that they are committed to their operating plan and its tenets, without any real commitment.

Genesee & Wyoming October revenue units for its North American operations increased 8.1 percent on significant gains in coal and metals. Coal, Aggregates and Sand, STCC 28 Chems and Fertilizers, Forest Products, and Metals accounted for 80 percent of the cars; even though Waste, Petroleum and Other scored larger percentage gains, none of these account for more than six percent of the total.

According to the GWR press release,

• Coal & coke traffic increased 4,565 carloads, or 25.4 percent, primarily due to increased shipments of steam coal in G&W’s Midwest Region.
• Metals traffic increased 2,125 carloads, or 18.8 percent, primarily due to increased finished steel and scrap steel shipments in G&W’s Southern, Midwest and Canada regions.
• Petroleum products traffic increased 1,702 carloads, or 23.1 percent, primarily due to increased shipments in G&W’s Canada, Northeast and Southern regions.
• Autos & auto parts traffic decreased 1,505 carloads, or 41.2 percent, primarily due to decreased shipments in G&W’s Western and Midwest regions.
• All remaining traffic increased by a net 4,212 carloads.

Year-to-date revenue units are up 6.4 percent. October was up 6.4 percent sequentially from September, which was down 12.0 percent from August. That was an aberration, though, as most months are up sequentially over their preceding months. It is particularly heartening to see metals continuing strong, ag getting a nice boost, and coal continuing to keep the lights on in Illinois.

Putting these results in context, AAR October US carloads ex-intermodal were up a point. petroleum products — chiefly crude oil — jumped 28.4 percent; coal added 1.6 percent; and primary metal products grew 9.8 percent. Commodities that saw declines were aggregates and sand, down 9.6 percent; and grain, down 4.8 percent. Commenting on these results, AAR Senior VP John Gray says,

> US railroad traffic in October was mixed. On the plus side, coal carloads rose for the first time in five months, and intermodal enjoyed its second-best month ever. On the negative side, changing market conditions for frac sand caused fewer carloads of crushed stone, sand, and gravel, while uncertainties in export markets helped keep grain carloads down. However, we expect most rail traffic categories to continue to benefit from what we hope will be continued solid economic growth.

Light sweet crude for December delivery (ticker CLZ18) closed Monday at $59.03, a price not seen since mid-March, and marking the 11th straight day of losses — the longest losing streak ever. WTI settled at $59.93. Trading volumes have been at record highs. From the WSJ:

> Oil prices have also taken a hit from concerns about slowing demand growth, particularly as supply has come roaring back. Stock market instability, which sparked the initial selloff in oil, also returned on Monday, with the Dow Jones Industrial Average down more than 500 points on anxiety over the health of major tech companies. The S&P 500 was recently down 1.7 percent and the Nasdaq Composite fell 2.5 percent.

There may be a bright side for US shale drillers, though. The NY Times quotes Julian Lee of Bloomberg Opinion, who warns that the Saudis and others pushing up prices "would motivate U.S. shale producers — who have already driven up global supplies — to pump more petroleum. OPEC members are facing a long, slow grind with no end in sight."

The RJ Corman Railroad Group is buying Bill Drunsic's Nashville operations — the Nashville & Eastern Railroad (NERR), the Nashville & Western Railroad (NWR), and the Transit Solutions Group, a commuter rail operation and three related operating entities.

NERR is a 130-mile railroad that is operating on leased track from the Nashville and Eastern Railroad Authority from Nashville to Monterey, Tenn. The NWR is an 18-mile railroad, operating on leased track from the Cheatham County Rail Authority from Nashville to Ashland City, Tenn. Combined, the two names handle some 12,000 carloads annually, interchanging with CSX in Nashville. The transaction closes in January.

The AAR *Rail Time Indicators* for October (Nov 8) says that as of November 1, 2018, nearly 300,000 freight cars — 17 percent of the 1.7 million-unit North American rail freight car fleet, including intermodal platforms and auto racks, remained "in storage," i.e. empty and ready for revenue loads. Covered hoppers comprise the largest single car type at 35 percent of stored cars. Not surprisingly, tank cars at 33 percent are number two, and open-top hoppers — mainly coal — are third at 20 percent.

PFL Petroleum Services adds that frac sand cars were the major contributor to the CH weakness. Sand users now favor local truck-sourced sand and there has been a slowdown in well completions. "While we saw a slight increase in overall railcars in storage, it appears the trend for most car types outside of covered hoppers remain strong for lessors, but not so good for storage operators."